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No. 436

In the Supreme Court of the United States

OCTOBER TERM, 1940

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF JOHN M. ENRIGHT, DECEASED, JAMES G. ENRIGHT, EMMA E. NEILSON AND MILDRED L. ENRIGHT, EXECUTORS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit entered in the above-entitled cause on June 17, 1940.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 18) is a memorandum opinion and therefore not

officially reported. The opinion of the Circuit Court of Appeals is reported in 112 F. (2d) 919.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 17, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether his share of income earned, but not yet received, by a partnership should be included in the gross income of a partner for the taxable period ending with his death, where both the partnership and the deceased partner kept books on the cash basis.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 8–10.

STATEMENT

The relevant facts, as stipulated by the parties (R. 38–49) and as found by the Board of Tax Appeals (R. 20–22), may be summarized as follows:

John M. Enright, who died on November 19, 1934, was a partner in a law firm in Jersey City, New Jersey, up to the time of his death (R. 20, 38). All the partners were upon a cash basis (R. 20, 44). The net income of the firm, which was upon a cal-

endar year cash receipts basis, was distributable as follows (R. 20, 39):

	Percent
John M. Enright	34½
James D. Carpenter, Jr.	34½
Howard S. Gilmour	13
Carl S. Kuebler	9
Patrick A. Dwyer	9

The partnership agreement provided that, in the event Enright died, his interest would consist of his interest upon the above percentage basis in cash, accounts receivable and "the unearned proportion of the estimated receipts from unfinished business." The decedent by his will directed his executors to accept the valuation placed upon partnership items by James D. Carpenter, Jr. The surviving partners formed a new partnership immediately after Enright died and continued the business. The new agreement provided that Carpenter was to estimate the earned portion of receipts from unfinished business for the purpose of paying the Enright estate. (R. 20–21, 39–41.)

At the date of his death, Enright's interest in partnership cash was $4,143.81 and his interest in collectible accounts receivable was $2,055.55. The partnership at that time was handling over 400 pending cases in which work had been done, and on which additional work had to be done before the amount of fees to be charged could be determined and billed to clients. Carpenter estimated that the firm had earned by work upon those cases up to November 19, 1934, about $118,422.51

and that Enright's interest therein was $40,855.77. The $2,055.50 item and the $40,855.77 item, or $42,911.32, were reported as a part of Enright's estate for state and federal estate tax purposes. (R. 21, 42–43.)

The share of Enright in cases being handled upon the basis of a fixed fee was $1,024.89, but those fixed fees were payable after his death upon a monthly or yearly basis. Almost all other cases were being handled under understandings with clients that the fee would be a reasonable amount for work done, taking into account, results, time and effort, and the amount involved. Only a few cases were being handled upon a contingent fee basis and such cases Carpenter valued in his estimate at one dollar. (R. 21, 43.)

As the new firm made collections on old business it paid Enright's share to his estate. (R. 21, 44–48.)

The executors filed a return for Enright for 1934 and included his share of the partnership cash, $4,143.81. The Commissioner, in determining the deficiency, added $42,911.32, representing his share of accounts receivable and his share of estimated earnings to the date of his death. (R. 13, 21, 42.)

The new firm, up to the date of the hearing, had collected $46,293.75 upon Enright's share of old business and had paid $45,965.15 to the estate. (R. 22, 45, 48.)

The following additional facts were found by the Board from testimony of Carpenter (R. 22, 35):

The amount estimated as Enright's share of earned fees on unfinished business would not have been realized in full had the new firm not completed the business.

Enright was on a cash basis and did not receive any of the $42,911.32 in controversy.

The Board of Tax Appeals determined that the decedent's share of partnership profits for the period ending with his death should be included in his gross income for that period (R. 23). On appeal, the Circuit Court of Appeals for the Third Circuit, with Judge Biggs dissenting, reversed the decision of the Board.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the decedent's share of profits earned, but not yet received, by the partnership should not be included in his gross income for the period ending with his death, within the meaning of Section 42 of the Revenue Act of 1934.

2. In failing to hold that the decedent's share of income earned, but not yet received, by the partnership should be included in his gross income for the period ending with his death, within the meaning of Section 42 of the Revenue Act of 1934.

3. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the Third Circuit in this case is in direct conflict with the decision of the Circuit

Court of Appeals for the Second Circuit in *Pfaff* v. *Commissioner*, 113 F. (2d) 114.

Both cases arise upon substantially identical facts.[1] In the *Pfaff* case the taxpayer, until the time of his death in December of 1935, was a member of a medical partnership, which had taken over the assets and assumed the liabilities of a prior medical partnership. Each of the partnerships and the taxpayer maintained accounts on a cash basis. At the date of the taxpayer's death, there were accounts outstanding in the amount of $69,601.59 for services rendered to patients during his lifetime. A portion of these accounts was collected during the balance of 1935 and during 1936, and taxpayer's share was paid to his estate. The question presented in the *Pfaff* case, just as in the case at hand, was whether income earned, but not yet received, by the partnerships should be included in the gross income of the partner for the period ending with his death, where both the partnerships and the deceased partner were on a cash basis. The Board of Tax Appeals determined that such income should be included, and the Circuit Court of Appeals for the Second Circuit affirmed *per curiam*.

2. This case raises an important question concerning the construction of Section 42 of the Revenue Act of 1934 with reference to its application

[1] The facts in the *Pfaff case* are taken from the opinion of the Board of Tax Appeals which is a memorandum opinion and therefore not officially reported.

to partnership accounting for income tax purposes. The legislative history of Section 42,[2] as well as its terminology, discloses that Congress thereby intended to tax to the decedent all income earned during his lifetime which, under the prior law, was treated as capital and not income to his estate. Accordingly, it taxed to such decedent amounts "accrued" up to the date of his death.[3] In order to carry out this Congressional purpose, and prevent escape from the income tax, Section 42 should be held applicable to the situation at bar. This is an important question in the administration of the revenues which should be, but probably has not been, determined by this Court. See *Guaranty Trust Co.* v. *Commissioner,* 303 U. S. 493; *Bull* v. *United States,* 295 U. S. 247.

CONCLUSION

It is therefore respectfully submitted that, for the reasons stated, this petition for a writ of certiorari should be granted.

FRANCIS BIDDLE,
Solicitor General.

SEPTEMBER, 1940.

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[2] See H. Rep. No. 704, 73d Cong., 2d Sess., p. 24; S. Rep. No. 558, 73d Cong., 2d Sess., p. 28.

[3] The Board found (R. 22–23) that the taxayer's right to receive the additional amount assessed was sufficiently fixed and determined at his death, *Lucas* v. *American Code Co.*, 280 U. S. 445, and that the amount was ascertainable with reasonable accuracy, *Continental Tie & L. Co.* v. *United States*, 286 U. S. 290, for income-tax accounting purposes.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period. [U. S. C., Title 26, Sec. 42.]

SEC. 48. DEFINITIONS.

When used in this title—

(a) *Taxable Year.*—"Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. "Taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made.

* * * * *

[U. S. C., Title 26, Sec. 48.]

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. [U. S. C., Title 26, Sec. 181.]

SEC. 182. TAX OF PARTNERS.

There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year. [U. S. C., Title 26, Secs. 182, 188.]

SEC. 187. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners. [U. S. C., Title 26, Sec. 187.]

New Jersey Revised Statutes (1937, Vol. II, Title 42:

PARTNERSHIPS AND PARTNERSHIP ASSOCIATIONS

ARTICLE 6. DISSOLUTION AND WINDING UP.

42:1-29. *Dissolution defined.*—The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business.

42:1-30. *Partnership not terminated by dissolution.*—On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed.

42:1–31. *Causes of dissolution.*—Dissolution is caused:

* * * * *

4. By the death of any partner;

* * * * *

42:1–43. *Right to accounting on dissolution.*—The right to an account of his interest shall accrue to any partner, or his legal representative, as against the winding up partners, or the surviving partners, or the person or partnership continuing the business, at the date of dissolution, in the absence of any agreement to the contrary.

Treasury Regulations 86, relating to the Revenue Act of 1934:

ART. 42–1. *When included in gross income.*—Except as otherwise provided in section 42 in the case of the death of a taxpayer, gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. (See articles 41–1 to 41–3.) If a taxpayer has died there shall also be included in computing net income for the taxable period in which he died amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period, regardless of the fact that the decedent may have kept his books and made his returns on the basis of cash receipts and disbursements. * * *

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